



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/25/00	Bill No:	AB 2764
Tax:	Sales and Use	Author:	Knox
Board Position:		Related Bills:	AB 410 (1997)

BILL SUMMARY:

This bill would provide that a licensed acupuncturist is the consumer, and not the retailer, of herbs and other substances, as specified, used or furnished in the performance of his or her professional services.

ANALYSIS:

Current Law:

Under existing law, sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. Persons engaged in the business of rendering services are generally not considered retailers, but instead, are considered consumers of any tangible personal property incidentally transferred in the performance of their services. As consumers, tax applies to the service providers' purchase of any property used in the performance of their services.

The Board's Sales and Use Tax Regulation 1501, "Services Enterprises Generally," provides that the basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax, even though some tangible personal property is incidentally transferred.

Current law already regards acupuncturists as consumers of any tangible personal property used incidentally in the performance of their services where no separate charge is made to their clients for any tangible personal property sold, and the price of any tangible personal property incidentally transferred to the client is built into the acupuncturists' fee schedule. However, where a separate charge is made by the acupuncturist to the client for any tangible personal property transferred to the client, current law requires that tax applies to that charge.

Under the law, the following service providers have specifically been deemed to be consumers, rather than retailers, of certain items that they use or furnish in the performance of their professional services:

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- Optometrists, physicians and surgeons, and registered dispensing opticians with respect to ophthalmic materials for the treatment of conditions of the human eye. (Section 6018)
- Veterinarians with respect to certain drugs and medicines. (Section 6018.1)
- Chiropractors with respect to vitamins, minerals, dietary supplements and orthotic devices. (Section 6018.4)
- Podiatrists with respect to prosthetic materials and inlays in the diagnosis, treatment, or correction of conditions of the human foot. (Section 6018.5)
- Licensed hearing aid dispensers with respect to hearing aids. (Section 6018.7)
- Producers of x-ray films or photographs with respect to materials and supplies used for the purpose of diagnosing medical or dental conditions of humans. (Section 6020)

Proposed Law:

This bill would add Section 6018.3 to the Sales and Use Tax Law to provide that a licensed acupuncturist is a consumer of, and shall not be regarded as a retailer with respect to, any herb, herb formulas or preparations, vitamins, minerals, dietary supplements, orthotic devices, or other naturally occurring substances included in the Encyclopedia of Traditional Chinese Medicinal Studies that is used or furnished by him or her in the performance of his or her professional services.

The provisions of the bill would become operative on the first day of the first calendar quarter commencing more than 90 days after the bill becomes law.

Background:

A similar measure was considered during the 1997-98 Legislative Session. That measure, AB 410 (Gallegos), was held in the Senate Appropriations Committee. The Board was originally opposed to that measure due to an undefined term used in the bill that would have lead to uncertainties in the Board's administration of the law. However, the bill was later amended to remove the undefined term, which resulted in the Board's removal of its opposition.

COMMENTS:

1. **Sponsor and purpose of the bill.** The sponsor of this measure is the Council of Acupuncturists and Oriental Medicine. Its purpose is to treat acupuncturists in a similar manner as the law currently treats other healthcare professionals, such as chiropractors and podiatrists.
2. **The bill's effect is limited.** This bill would make acupuncturists consumers of specified items used or furnished in the performance of his or her professional services, regardless of the method of billing. As a consumer, the acupuncturist would pay tax on only his or her cost of the items. However, it should be noted that any retail sales of these items that are made separately from the professional services rendered would continue to be subject to tax based on the retail selling price to the consumer. For example, even with the enactment of this measure, the

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acupuncturist would continue to be responsible for tax based on the selling price of an item to the client if the acupuncturist separately charges an amount and does not provide professional services in conjunction with the supplying of the item. Therefore, an acupuncturist that operates a retail vitamin, mineral, or dietary supplement store, for example, would continue to be required to report the tax on the retail selling price of the items sold, unless he or she can show that they were furnished along with his or her professional services.

- 3. Enactment of this measure would not complicate the Board's administration of the law.** Since the Board already administers similar provisions for chiropractors, podiatrists, eye care professionals, and others, staff does not anticipate any problems with administering the provisions proposed in this measure.

COST ESTIMATE:

Enactment of this measure would result in a minor decrease in administrative and audit costs due mainly to a reduction in the number of acupuncturists required to hold a seller's permit. However, any savings would be offset by the minor additional costs that would be incurred in notifying acupuncturists, closing out permits, and revising the Board's affected regulation.

REVENUE ESTIMATE:

According to the California Association of Acupuncture and Oriental Medicine (CAAOM), there are approximately 5,200 active, licensed acupuncturists in California as of January 1, 2000. Of the 5,200 acupuncturists, only 3,432, or 66 percent, sell herbs, vitamins, or other naturally occurring substances. For the year 1999, an analysis of the sales and use tax returns filed with the Board of Equalization by acupuncturists shows that, on average, an acupuncturist reports about \$11,700 per year in taxable sales. Estimated sales for all acupuncturists in the state of California reselling herbal products are \$40.2 million (3,432 acupuncturist x \$11,700). The mark-up on herbal products sold to patients by acupuncturists is approximately 33.2 percent. Therefore, the estimated total cost of the herbal products to acupuncturists is \$30.2 million ($\$40.2 / 1.332$). The amount that would no longer be subject to tax pursuant to this measure is the difference between total retail sales by acupuncturists and the acupuncturists' purchase price of those products, or \$10 million (\$40.2 million - \$30.2 million).

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Revenue Summary

Exempting the \$10 million from the sales and use tax would result in the following annual revenue loss:

Revenue Effect

State loss (5%)	\$ 500,000
Local loss (2.25%)	225,000
Transit loss (0.67%)	<u>67,000</u>
Total	<u>\$ 792,000</u>

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